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Comment: The Ohio Income Tax

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COMMENT

The Ohio Income Tax

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CRITICS OF GOVERNOR JOHN J. GILLIGAN might characterize Ohio's new state tax legislation in the same manner that an eminent literary scholar in the Versailles Court once judged a sonnet by Louis XIV. "Sire," he exclaimed, "nothing is impossible for your Majesty. You set out to write some bad verses and you have succeeded."[1]

Yet, despite the omissions, inconsistencies, and questionable policy judgments embodied in Ohio's first personal income tax[2] and first corporate franchise tax measured by net income,[3] a more balanced assessment would judge the legislation as something more than the minimal fulfillment of a campaign pledge.[4] Not only has Ohio become the 44th state to enact personal and corporate income taxes,[5] but it has for the first time enacted taxes containing graduated rates. And while raising funds for the critical areas of education, welfare and mental health, the expectation of increased revenue from the new taxes permitted the state to reduce property taxes by 10 percent[6] and to authorize a homestead exemption for low-income per-

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1 Attributed to M. Boileau by Irving Babbitt. I. BABBITT, THE MASTERS OF FRENCH CRITICISM 338 (1912).

2 OHIO REV. CODE §§ 5747.01-.99 (Baldwin's Ohio Tax Law and Rules Service Supp. 1972 [hereinafter cited as Baldwin Supp. 1972]).

3 OHIO REV. CODE §§ 5733.01-.99 (Baldwin Supp. 1972). The corporate tax is still formally a tax levied on the privilege of exercising a franchise in Ohio, although it will be measured by net income in most cases. The new tax is almost universally called a corporate income tax, and will be so described here.

4 Governor Gilligan's 1970 campaign stressed the need for a state personal income tax. His Republican opponent, Roger Cloud, advocated raising the admittedly necessary revenue by other means. *See* The Plain Dealer (Cleveland, Ohio), Dec. 11, 1971, § A, at 12, col. 1 [hereinafter cited as Plain Dealer Report].

5 The District of Columbia also imposes such taxes. The six states without personal and corporate income taxes are Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. *See* CCH STATE TAX GUIDE pp. 1501-02 (1972). A few of the 44 states tax individuals only on investment income. *See generally* CCH STATE TAX GUIDE ¶¶ 15-000 to -949 (1972).

6 OHIO REV. CODE § 319.301 (Baldwin Supp. 1972). The beneficent impact of this relief may be modified by the new requirement that real property be assessed at a uniform state-wide percentage of market value. Ohio Bd. of Tax Appeals Rule BTA-5-01 (uniform "assessed valuation" rate of 50% of market value). The ruling was issued in re-

sons over 65.[7]

Although the new taxes took effect January 1, 1972,[8] and withholding on personal income began at that time, there will be an initial period of confusion which will not be dispelled overnight. Many details remain to be worked out before a definitive analysis of particular provisions will be possible. A technical amendments bill — designed to cure errors in the legislation which could not be corrected before passage because of time pressure — is necessary but will not be enacted during this session. Eventually the Tax Commissioner will promulgate detailed regulations and enunciate policy in those areas in which he will exercise discretion. Therefore, any attempt at a thorough analysis of the Ohio income tax is somewhat premature.

This Comment consequently focuses on general aspects of the new tax legislation and does not purport to be an exhaustive treatment of the area. Although it mentions specific provisions and difficulties of particular interest, the Comment emphasizes a comparison of Ohio's taxes to those of other states and an analysis of the real burden of the taxes on differently situated taxpayers.

I. THE PERSONAL INCOME TAX

A. *History*

The graduated personal income tax was the most controversial feature of the 1971 tax legislation. Although a 1912 Ohio constitutional amendment had authorized such a tax,[9] legislative efforts to enact the tax had previously been unsuccessful.[10] Governor John J. Gilligan introduced a bill in March, 1971, calling for rates graduated up to 8 percent.[11] The Ohio House, in August 1971, responded by passing a personal income tax with a top rate of 4 percent.[12] While the House remained faithful to this revenue-rais-

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sponse to State *ex rel.* Park Investment v. B.T.A., 16 Ohio St. 2d 85, 242 N.E.2d 887 (1968) (the B.T.A. has a duty to assure that all property within the state is assessed at a uniform percentage of its true value in money). *See* OHIO CONST. art. XII, § 2.

[7] OHIO REV. CODE §§ 323.151-.99 (Baldwin Supp. 1972).

[8] Am. Sub. H.B. 475, 109th Gen. Assembly (1971), was passed on Dec. 10, 1971, was signed by the Governor on Dec. 20, 1971, and became effective as of that date. The substantive provisions effect the reporting and payment of taxes beginning Jan. 1, 1972.

[9] OHIO CONST. art. XII, § 8.

[10] *See* Plain Dealer Report at col. 1.

[11] H.B. 475, 109th Gen. Assembly (1971) (as originally introduced). *See* Plain Dealer Report at col. 1.

[12] H.B. 475, 109th Gen. Assembly (1971) (as passed by the House). *See* Plain Dealer Report at col. 1.

ing approach, the Ohio Senate persistently sought an increase in the state sales tax.[13] The deadlock between the House and Senate continued for three months until a series of compromises between the legislators of both houses and the support of organized labor resulted in the enactment of the present personal income tax legislation.

B. *Basic Structure*

The new personal income tax is imposed on "every individual residing in or earning or receiving income in this state."[14] Withholding is required of all employers "maintaining an office or transacting business within this state."[15] Exempt from such withholding are the armed forces, agricultural labor, domestic service, and transient labor.[16] Taxpayers not subject to withholding must file estimated returns comparable to those filed under the federal income tax law.[17]

The Ohio tax is computed on *adjusted gross income*, as determined by federal tax law. Certain additional income, tax-free for federal purposes, is taxable in Ohio; the most notable inclusion is interest from government obligations, except those of Ohio and its subdivisions.[18] Persons filing joint federal returns must do so in Ohio.[19] The taxpayer is not allowed any personal deductions but is permitted a $500 exemption for each dependent including the taxpayer, up to $3,000.[20] This latter feature is mandated by the 1912 constitutional amendment, which limits exemptions to a total of $3,000 and further provides that the tax may be either uniform or graduated.[21]

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[13] H.B. 475, 109th Gen. Assembly (1971), as amended by the Senate and passed on Sept. 25, 1971, would have added 1.5 percent to the preexisting 4 percent sales tax. *See* Plain Dealer Report at col. 2.

[14] OHIO REV. CODE § 5747.02 (Baldwin Supp. 1972).

[15] OHIO REV. CODE § 5747.06 (Baldwin Supp. 1972).

[16] Employers Ohio Income Tax Withholding Instructions and Tables, Jan. 1972, § 3 (Baldwin Supp. 1972).

[17] OHIO REV. CODE § 5747.09 (Baldwin Supp. 1972).

[18] OHIO REV. CODE § 5747.01(A) (Baldwin Supp. 1972).

[19] OHIO REV. CODE § 5747.08(E) (Baldwin Supp. 1972). And all employees must claim the same number of exemptions as he or she does for federal withholding. Employers Ohio Income Tax Withholding Instructions and Tables, Jan. 1972 § 5B (Baldwin Supp. 1972).

[20] OHIO REV. CODE § 5747.02 (Baldwin Supp. 1972).

[21] OHIO CONST. art. XII, § 8. Some state constitutions require uniformity of taxation. In Amidon v. Kane, 444 Pa. 38, 279 A.2d 53 (1971), the Supreme Court of Pensylvania invoked the state's uniformity clause (PA. CONST. art. VIII, § 1) to invalidate an income tax based on income as reported on the federal tax returns. The court said

C. *Rates*

The rates, after reduction of adjusted gross income by the allowable exemptions, are reproduced in Table 1. While this table suggests a slow but steady graduated rate structure, the reality of the economic impact is somewhat different. Since the Ohio income tax will be fully deductible from the federal tax for those who itemize deductions,[23] many taxpayers will salvage part of their Ohio tax payments in the form of reduced federal tax liability — and the higher the federal tax bracket, the greater the recovery.

TABLE 1

Ohio Individual Income Tax Rates[22]

Income ($)	Tax[a]
0–5,000	½ percent
5–10,000	$25 plus 1 percent of excess over $5,000
10–15,000	$75 plus 2 percent of excess over $15,000
15–20,000	$175 plus 2.5 percent of excess over $15,000
20–40,000	$300 plus 3 percent of excess over $20,000
over 40,000	$900 plus 3.5 percent of excess over $40,000

a. The Ohio tax is computed on adjusted gross income, less $500 for each dependent up to a limit of $3,000.

The net effect of the Ohio tax on differently situated taxpayers is illustrated by Table 2. This table indicates that the percentage of income actually paid gradually rises, as one would expect, up to $40,000. At that point, however, the Ohio tax rate ceases to climb while federal brackets — and the concomitant effective deduction — continue increasing up to $200,000.[24] Consequently, the Ohio personal income tax costs the high-income taxpayer a smaller percentage of his income than it costs his middle-income counterparts. This disparity continues to the point that a taxpayer earning $250,000 annually pays a smaller net percentage than any other taxpayer earning

varying deductions treated similarly situated taxpayers unequally. The legislature quickly enacted a new income tax based on a different computation method.

22 OHIO REV. CODE § 5747.02 (Baldwin Supp. 1972).

23 INT. REV. CODE OF 1954, § 164.

24 INT. REV. CODE OF 1954, § 1.

TABLE 2

Married Taxpayer — Joint Return

Base Figure (Ohio Income After Exemptions)	Ohio Tax	Federal Tax Savings	Net Ohio Tax Cost[c]	Percentage[d] of Income
$ 5,000	$ 25	$ 0[a]	$ 25	0.50
7,500	50	0	50	0.67
10,000	75	0	75	0.75
15,000	175	43[b]	132	0.88
20,000	300	84	216	1.08
25,000	450	144	306	1.22
30,000	600	216	384	1.28
40,000	900	378	522	1.31
50,000	1,250	600	650	1.30
100,000	3,000	1,740	1,260	1.26
150,000	4,750	3,040	1,710	1.14
200,000	6,500	4,420	2,080	1.04
250,000	8,250	5,775	2,475	0.99
500,000	17,000	11,900	5,100	1.02

a. It is assumed that taxpayers earning $10,000 or less will *not* itemize, and hence will derive no federal savings from the Ohio tax.

b. It is assumed that itemized federal deductions will equal 15 percent of the base figure. The difference between the federal income tax computed on the base figure less the assumed 15 percent and the federal income tax computed on the base figure less both the 15 percent and the Ohio tax produces the federal tax savings. The table does not consider complications that may arise from the new maximum tax on earned income or from tax preference items.

c. Tax cost is the additional amount of taxes that must be paid by the taxpayer as a result of the Ohio income tax.

d. Percent of income is the percent of the base figure which the tax cost represented.

more than $20,000. This analysis indicates that if the tax is to be truly progressive graduation must continue beyond the $40,000 income level.[25] Since the taxpayer will receive a federal tax deduction for every dollar paid in state taxes, a person in the 70 percent federal tax bracket effectively recovers 70 percent of his state tax. Thus, the effective state tax cost on such an individual's marginal income is only 30 percent of the maximum state tax rate of 3.5 percent — an effective rate of 1.05 percent. It is therefore evident that any increase in state tax rates on large incomes would be paid primarily by

[25] It must be pointed out, however, that most states stop graduation far below this level. See notes 46-47 *infra* & accompanying text.

the federal government, while spreading the Ohio tax burden more equitably among Ohio taxpayers.

D. *Deductions*

One of the less discussed features of the new income tax is its failure to allow personal deductions. This legislative decision may have been motivated by either the prevalent state practice of denying most deductions,[26] the desire for maximum simplicity, or the language of the 1912 amendment authorizing "exemptions" but not mentioning "deductions."[27] Further, since the Ohio tax is thus based on adjusted gross income, rather than the significantly lower taxable income, the rates have a greater economic impact than is readily apparent and are higher in relation to federal tax rates than might be supposed.

The policy of disallowing personal deductions need not be seriously questioned. The taxpayer may feel that he is being denied some economic benefit, but it must be noted that most personal deductions allowed under federal tax laws are voluntary in the sense that the taxpayer has alternatives available. For example, charitable contributions are entirely elective, and Ohio understandably has little interest in granting tax incentives to make gifts to out-of-state charities or even national ones. There may even be positive merit in disallowing mortgage interest and property tax deductions, thus eliminating the federal preference given to owners over renters. Moreover, since the Ohio tax legislation reduced property taxes, any deduction would be a double benefit.

In the area of medical expenses, however, the state practice seems unduly draconian. If a taxpayer earns $20,000 but must spend virtually all of it for kidney dialysis and medical expenses just to stay alive, it seems totally unjust to subject him to the $300 tax paid by others in that bracket. A comparable injustice in the federal tax law, imposing a *ceiling* on medical deductions, was previously repealed.[28] While it may not be necessary to permit deduction of expenses in the relatively small amounts allowed federally,[29] Ohio should authorize deductions for medical expenses in excess of per-

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26 *See generally* CCH STATE TAX GUIDE ¶ 15-000 (1972).

27 OHIO CONST. art. XII, § 8 states that "a part of each annual income not exceeding three thousand dollars may be exempt from such taxation."

28 INT. REV. CODE OF 1954, § 213(C), repealed as of Jan. 1, 1967, limited the

29 INT. REV. CODE OF 1954, § 213 generally permits deduction of medical expenses
medical deduction to $5,000 per exemption with a ceiling of $20,000 on a joint return.
in excess of 3 percent of adjusted gross income.

haps 10 percent of adjusted gross income. If the 1912 amendment is thought to prevent unlimited deductions, legislation could authorize a medical exemption to the extent personal exemptions do not reach $3,000.

Despite the policy of disallowing personal deductions, the new Ohio tax law does authorize one special deduction not available federally. Section 5747.01(A) permits an exclusion from adjusted gross income for income attributable to the taxpayer by reason of an interest in a Subchapter S corporation. This is the corollary to the legislature's decision to subject Subchapter S corporations to the corporate income tax,[30] presumably done because of the higher corporate tax rate.

E. *Intangibles Tax*

Ohio has long had an intangibles tax,[31] which features a 5 percent tax on income yield from dividends and a two-mill tax on the value of unproductive assets.[32] Although some attempt was made to repeal this tax as part of the income tax package,[33] the ultimate legislation did not affect it. But to avoid a levy which could be as high as 8.5 percent on dividend income, the income tax excludes amounts of investment income on which the intangibles tax has been paid.[34] Despite this one concession, however, the retention of the intangibles tax means that a flat tax higher than any earned income rate will still be imposed on dividends and certain other income. While this treatment may compensate for federal preferences given to investment income, such as the $100 dividend exclusion[35] and the capital gains tax,[36] it can be questioned whether it is worth the effort required of taxpayers and government officials to file and process two separate returns. Certainly, if a higher tax on dividends was desired, it could have been incorporated into the income tax, thus permitting abolition of the separately administered intangibles tax.

It should be noted that taxpayers liable for intangibles tax do not automatically obtain the exclusion: they must actually have *paid* "nondelinquent" intangible property tax.[37] Because of the dis-

[30] OHIO REV. CODE § 5733.01(C) (Baldwin Supp. 1972).

[31] OHIO REV. CODE § 5707.04 (Baldwin Supp. 1972).

[32] OHIO REV. CODE § 5707.04(A), (B) (Page 1953).

[33] The original bill, H.B. 475, eliminated the 5 percent tax on dividends entirely.

[34] OHIO REV. CODE § 5747.01(A) (Baldwin Supp. 1972).

[35] INT. REV. CODE OF 1954, § 116.

[36] INT. REV. CODE OF 1954, § 1201.

[37] OHIO REV. CODE § 5747.01(A) (Baldwin Supp. 1972).

parity of the filing periods of the two taxes, this requirement creates a bizarre situation. The intangibles tax is payable *between* February 15 and April 30[38] while the income tax return is *due* April 15.[39] An efficient and conscientious Ohio taxpayer desiring to file his income tax return before February 15 could literally not claim the credit because he could not yet pay his intangibles tax. Similarly, a taxpayer preferring to wait to April 30 to pay his nondelinquent intangibles tax could not claim the deduction on his income tax return filed April 15. Finally, the present intangibles tax can properly be paid without interest in two installments,[40] but the second payment could not be considered paid by April 15.

To avoid these difficulties the Tax Commissioner has tentatively taken the position that the income exclusion will apply to the amount of income on which intangibles tax was paid during the tax year, rather than in the year the return is filed.[41] Under this approach a taxpayer preparing his 1972 Ohio income tax return in the spring of 1973 would exclude the amount of income on which he paid his 1972 intangibles tax. This "solution" avoids the timing difficulties but produces mismatching of income and exclusion. Since the 1972 intangibles tax is measured by 1971 income, the taxpayer would obtain an exclusion for income which was not even subject to the income tax. Moreover, the exclusion apparently is totally unrelated to actual intangible income during the tax year; a taxpayer who liquidated his investments in early 1972 and received no dividend income would be allowed to exclude a portion of his *earned* income by virtue of having paid a 1972 intangibles tax measured by 1971 income.

F. *Comparison to Other States*

While enactment of the personal income tax has caused some Ohio citizens to believe that they are overtaxed, comparison of the new legislation to rates in other states is sobering. While the state tax structures vary considerably, and any estimate of comparative burden can be only approximate because of the wide variation in allowable deductions and exclusions, it seems clear that the new Ohio rates are modest in comparison to those prevailing elsewhere,

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38 OHIO REV. CODE § 5711.04 (Page Supp. 1970).

39 OHIO REV. CODE § 5747.08(G) (Baldwin Supp. 1972).

40 OHIO REV. CODE § 5719.02(B) (Page Supp. 1970).

41 OHIO DEP'T OF TAXATION, INSTRUCTIONS AND FORMS FOR FILING DECLARATION OF ESTIMATED INDIVIDUAL INCOME TAX No. 3(f) (1972); OHIO DEP'T OF TAXATION, TAXPAYER INFORMATION GUIDE No. 18 A. (5) (1972).

especially in major industrial states. Ohio's bottom bracket of .5 percent is matched only by Oklahoma:[42] no other state begins its tax at lower than 1 percent. Further, only three states[43] impose a lower maximum rate than Ohio's 3.5 percent and two of these states are constitutionally barred from levying graduated taxes.[44] While in specific instances an Ohio taxpayer at a particular income level might pay more than his counterpart in another state because of the aforementioned variations, it would appear that Ohio ranks low in tax burden — particularly when compared to New York's 15 percent maximum rate, New Jersey's 14 percent maximum rate, and California's 11 percent maximum rate beginning at $15,500.[45]

Ohio does, however, carry the graduation principle further than do most states: only four states[46] impose additional brackets above Ohio's $40,000 maximum level. Most states, in fact, cease graduation below $20,000, so that the partially regressive nature of the burden calculated after federal taxes would presumably be more significant than in Ohio.[47]

G. *Major City Comparison*

The comparison of other states to Ohio can be more sharply focused by limiting the examination to populous states with major metropolitan areas. In these states, common problems such as welfare, housing and education presumably require substantial spending.

Table 3 presents data on income taxes in the twenty largest cities in the United States, analyzed in terms of comparative rates. City income taxes, which apply in six of the metropolitan areas, including Cleveland, were included as part of total income taxes.[48] The maxi-

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[42] OKLA. STAT. ANN. tit. 68, § 2355(A) (Supp. 1971-72).

[43] Illinois, ILL. ANN. STAT. ch. 120, § 2-201(b) (Smith-Hurd Supp. 1972) (2.5 percent); Indiana, IND. ANN. STAT. § 64-3218 (Supp. 1971) (3 percent); Pennsylvania, PA. STAT. ANN. tit. 72, § 3402-201 (1964) (2.3 percent).

[44] ILL. CONST. art. IX, § 3; PA. CONST. art. VIII, § 1. Other states have similar prohibitions. *See, e.g.*, MICH. CONST., art. 9, § 7.

[45] New York, Act of Jan. 5, 1972, ch. 1, § 3(b), [1971] N.Y. Laws 5 (McKinney Supp. 1972) *amending* N.Y. TAX § 602 (McKinney Supp. 1971-72); New Jersey, N.J. STAT. ANN. § 54:8A-6(b) (Supp. 1971-72); California, Act of Dec. 30, 1971, ch. 1, § 11 [1971] Cal. Laws 4263 (West's Cal. Leg. Service 1971) *amending* CAL. REV. & TAX CODE § 17041 (West Supp. 1971).

[46] Delaware, DEL. CODE ANN. tit. 30, § 1102 (Supp. 1970); Louisiana, LA. REV. STAT. ANN. § 47:32A (1970); Maine, ME. REV. STAT. ANN. tit. 36, § 5111 (Supp. 1972); West Virginia, W. VA. CODE ANN. § 11-21-4C (Supp. 1972).

[47] *See* notes 22-25 *supra* & accompanying text.

[48] For the data on state and city income taxes used in this analysis, see generally CCH STATE TAX GUIDE ¶¶ 15-200 to -949 (1972).

The possibility of additional small suburban income taxes was ignored. The Ohio

TABLE 3

Largest United States Cities[a] Ranked By City and State Income Tax Rates

City and State	Pop. Rank (1970 Census)	Rank Max. Rate	Rank Min. Rate	Rank $10,000 Rate	Composite
New York, N.Y.[b]	1	1	6	1	1
Milwaukee, Wisc.	12	2	5	2	2
Baltimore, Md.[b]	7	8	4	4	3
Phoenix, Ariz.	20	7	8	3	4
Washington, D.C.	9	6	8	5	5
Detroit, Mich.[b]	5	9	1	10	6
Los Angeles, Calif.	3	3	14	6	7–9
San Francisco, Calif.	13	3	14	6	7–9
San Diego, Calif.	14	3	14	6	7–9
Philadelphia, Pa.[b]	4	12	2	11	10
Boston, Mass.	16	13	3	12	11–12
St. Louis, Mo.[b]	18	10	12	6	11–12
New Orleans, La.	19	10	8	15	13
Chicago, Ill.	2	15	7	14	14
Cleveland, Ohio[b]	10	14	12	13	15–16
Indianapolis, Ind.	11	16	8	15	15–16
Memphis, Tenn.[c]	17	17	17	17	17
Houston, Texas	6	–	–	–	18–20
Dallas, Texas	8	–	–	–	18–20
San Antonio, Texas	15	–	–	–	18–20

a. City size is based upon the 1970 United States Census.
b. All computations and ranking include city income tax.
c. Because Tennessee taxes only investment income, it is impossible to accurately rank the tax burden on the citizens of Memphis.

mum combined city and state rates, beginning with New York's whopping 18.5 percent,[49] were ranked along with the city's minimum tax rate. Also, in an effort to cover the vast middle range of tax rates while still avoiding excessive complexity, the marginal rates on income just above $10,000 were ranked. Finally, the "composite" column weights equally the ranks in the aforementioned three categories.

Cleveland, Ohio's tax rate, despite the imposition of both city and state income taxes within a five-year period where no tax existed previously, ranks in the bottom quarter of the cities. Of those cities

state tax legislation specifically provides that city income tax legislation is not preempted and may continue. OHIO REV. CODE §§ 5747.01 (personal income tax), 5733.06 (corporate tax) (Baldwin Supp. 1972).

[49] New York City residents are taxed on the state level at a maximum of 15 percent on income over $25,000, and on the city level at a maximum of 3.5 percent on income over $30,000. *See* CCH STATE TAX GUIDE ¶ 15,681, ¶ 15,691 (1972).

below it, the three Texas cities have no income taxes, and residents of Memphis are subject only to a state tax on investment income.[50] Thus, among the larger cities in states levying a general tax, Cleveland's tax burden ties for last.

Although this table is hardly a definitive study, and does not consider the tremendous variation in state rate structures or exemptions and deductions, it at least demonstrates that the new tax legislation does not overburden Ohioans in relation to their compatriots in other populous areas. Even if the new tax is merely "a foot in the door" and increased rates can be expected soon, future increases could still leave Ohioans with a relatively light tax burden.

II. CORPORATE INCOME TAX

A. *General*

In contrast to the more publicized personal income tax, there was substantial agreement on the principle of a corporate tax measured by income. Both the Senate and House bills contained provisions basing franchise tax assessment upon a formula using Ohio income.[51] Despite considerable vacillation as to the proper corporate tax rate, the schedule finally agreed upon provides for a basic income tax of 4 percent on the first $25,000 of net income and 8 percent on all income in excess of $25,000.[52] The tax thus resembles the federal corporate tax since small corporations are taxed at about half the rate imposed on their bigger brothers.[53] On the other hand, the preexisting net worth franchise tax of five mills will be assessed if that produces a greater tax,[54] as it will when a company suffers a loss in a particular year.

The corporate income tax applies equally to Ohio corporations and foreign corporations doing business or qualified to do business here.[55] All must file an estimated tax declaration in January of

[50] TENN. CODE ANN. § 67-2602 (Supp. 1971).

[51] Presumably the franchise tax label was retained to avoid the strictures of OHIO CONST. art. XII, § 9, which requires at least half of all revenue from an income tax to be returned to local subdivisions. In contrast, OHIO CONST. art. XII, § 10 authorizes franchise taxes without mentioning allocation of funds.

[52] OHIO REV. CODE § 5733.06 (Baldwin Supp. 1972).

[53] The federal corporate tax is 22 percent on the first $25,000, and 48 percent on the excess. INT. REV. CODE OF 1954, § 11.

[54] OHIO REV. CODE § 5733.06 (Baldwin Supp. 1972). The proportionate value of Ohio property and sales to the corporation's total property and sales determines the taxable base. *See* OHIO REV. CODE § 5733.05 (Baldwin Supp. 1972). Section 5733.06 also provides for a minimum payment of $50 from all corporations.

[55] OHIO REV. CODE § 5733.01 (Baldwin Supp. 1972).

each year, followed by full payment of the estimated tax in installments on January 31 and March 31, and May 31 if an extension has been granted.[56] By March 31, or before any extension terminates, the taxpayer must file an official tax report accompanied by payment of the tax shown to be due on that report less the amount already paid.[57] The tax is in respect to the year in which payment is made, but is based on net income of the *previous year*. Thus, an Ohio corporation would pay its 1973 "franchise tax" based on its 1972 net income attributable to Ohio. The schedule of payment and returns applies even where the corporation is on a fiscal year rather than a calendar year, and net income in the most recent full fiscal year is used to measure the tax.[58]

The Ohio tax structure is, for the most part, closely modeled on the federal corporate tax. A corporation must use the same method of accounting and the same taxable year for both federal and Ohio purposes.[59] Changes in federal tax liability due to audit or agreement must be reflected in amended returns to Ohio.[60] The method of determining net income before apportionment[61] follows federal income tax rules, except for special provisions concerning net operating losses and capital gains and losses attributable to periods before the enactment of the Ohio tax.[62] Dividends from financial institutions, public utilities, insurance companies and the like are eliminated or reduced.[63] As in the personal income tax, there is a deduction of income on which intangible property tax has been paid.[64]

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[56] OHIO REV. CODE § 5733.021 (Baldwin Supp. 1972).

[57] OHIO REV. CODE § 5733.02 (Baldwin Supp. 1972).

[58] *See* OHIO REV. CODE §§ 5733.031(A), .04(E) (Baldwin Supp. 1972).

[59] OHIO REV. CODE § 5733.031 (Baldwin Supp. 1972).

[60] OHIO REV. CODE § 5733.031(C) (Baldwin Supp. 1972).

[61] *See* notes 65-66 *infra* & accompanying text.

[62] There is no provision for deducting the net operating loss incurred previous to the first year covered by the tax. Deduction of net operating loss and carryover of these losses is allowed commencing with the first year in which the tax is imposed. OHIO REV. CODE § 5733.04(I)(1) (Baldwin Supp. 1972). Capital gains or losses are excluded to the extent they occurred prior to the first year on which tax is computed. A formula for prorating those capital gains or losses that occurred in part before that year is provided. OHIO REV. CODE § 5733.04(I)(3). There is no comparable provision in the personal income tax for exclusion of preexisting gains and losses. The inconsistency is not explained and apparently may be corrected by legislation.

[63] OHIO REV. CODE § 5733.04(I)(6-8) (Baldwin Supp. 1972). As part of the new tax package, the tax on shares of capital employed by such entities was raised one mill. Beginning in 1972 financial institutions will pay three mills rather than two, and dealers in intangibles will be taxed at six mills rather than five. OHIO REV. CODE §§ 5707.03(D), .03(E) (Baldwin Supp. 1972).

[64] OHIO REV. CODE § 5733.04(I)(9) (Baldwin Supp. 1972).

B. *The Apportionment Formula*

The most complicated aspect of the corporate tax is the apportionment formula. Property, payroll and sales are weighted equally, and only the portion of each attributable to Ohio is used to measure the tax. Thus if an Ohio company had 75 percent of its property located in Ohio, made 50 percent of its sales here, and had 25 percent of its payroll here, it would pay tax on the average of these factors, or 50 percent of net income. The only exception to this rule is that where a company has, for example, no property in Ohio, that factor is dropped from the formula and the two remaining factors are averaged.[65] In all cases the formula compares Ohio assets and activities to the corporation's total assets and activities. The statutory rules for each category are summarized below.[66]

1. *Property.* Real property and tangible personal property, whether owned or rented, are allocated according to location. Property owned by the corporation is valued at original cost and rented property is valued at eight times the annual rental. Beginning and end of year values are normally averaged. Rents and royalties from Ohio property are allocated to Ohio, as are capital gains and losses. Dividends are apportioned according to the proportion of the book value of the payor's physical assets which are located in Ohio.

2. *Payroll.* Compensation is allocated to Ohio if the services are wholly or primarily performed in Ohio. Where some but not most of the services are performed in Ohio, the compensation is allocated to Ohio if the base of operations or the place from which services are controlled is in Ohio. Where the base of operations or place of control is not in a state where any services are rendered, the residence of the employee governs. Compensation to drivers of common carriers is allocated according to mileage inside and outside Ohio.

3. *Sales.* The sales factor is determined by a comparison of the value of sales of tangible personal property in Ohio with the value of the sales of tangible personal property everywhere. Receipt of property by the purchaser determines where the sale occurred, and direct delivery in Ohio to an agent of the purchaser constitutes an Ohio sale.

For sales other than tangible personal property, the sale is allocated to Ohio if the income-producing activity occurred entirely in

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65 OHIO REV. CODE § 5733.05(B)(2) (Baldwin Supp. 1972).

66 What follows is a summary of OHIO REV. CODE § 5733.05(B)(2) (Baldwin Supp. 1972).

Ohio, or if more costs of performance were incurred in Ohio than in any other state. Where solicitation of a sale is the income-producing activity, the place of solicitation controls. Any sale from an office in Ohio is considered an Ohio sale.

For unusual situations where the formula does not accurately reflect the corporation's Ohio activity, the statute provides special provisions in order for the corporate taxpayer to represent fairly its allocated or apportioned base in Ohio. Use of such methods must be approved by the Tax Commissioner.

C. *Consolidation*

The consolidated return provisions provide that any corporation owning directly or indirectly 50 percent of the voting stock of another taxpayer, or 50 percent of such stock of a corporation which controls another taxpayer, may elect to file consolidated returns. This election may not be changed for future years without the Tax Commissioner's approval. The Tax Commissioner in his discretion may require consolidated returns of qualifying corporations if he determines it necessary because of intercompany transactions.[67] On such returns intercorporate transactions and dividends are eliminated.[68] Any exemptions and deductions can be taken as if separate returns were filed.

The Tax Commissioner's approval is required in order for the taxpayer to consolidate a subsidiary not otherwise subject to Ohio tax. The Commissioner's approval, however, will rarely be granted because such aggregation could result in partial allocation of an Ohio parent's business income to the subsidiary's state. Thus Ohio parent corporations, in order to ensure consolidation and achieve the desired tax deflection, may wish to qualify foreign subsidiaries which they previously sought to keep out of Ohio.

D. *Comparison to Other States*

In contrast to the comparatively benign impact of the Ohio personal tax, the Ohio corporate tax is higher than most of its counterparts in other states. Of the 45 state corporate income taxes, only 10 are graduated:[69] consequently, the small Ohio corporation re-

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[67] OHIO REV. CODE § 5733.052 (Baldwin Supp. 1972).

[68] OHIO REV. CODE § 5733.052(D) (Baldwin Supp. 1972). Whether each corporation within the group will be able to take advantage of the lower tax rate for the first $25,000 of Ohio income is a question that is currently unanswered.

[69] *See generally* CCH STATE TAX GUIDE ¶ 10-000 (Table of Rates 1972). Arizona,

ceives a tax break not generally available. Among these states with corporate taxes, only three states tax incomes under $25,000 at a lower rate than Ohio does.[70] Conversely, larger corporations with more than $25,000 income taxable in Ohio are subject to an 8 percent rate which is exceeded in only six states.[71] And the corporate tax in most of Ohio's neighboring states is substantially lower.[72]

It is peculiarly necessary in the area of state corporate taxation to maintain a tax rate which is consistent with that in other states. A comparatively excessive personal tax will arouse resentment but can spur little rebellion since income-shifting possibilities are minimal and most individuals are tied to their jobs. Corporations, however, can defend against a high corporate tax by shifting personnel, transactions and inventory across state lines, or even by moving to a more hospitable taxing climate. Ohio's 8 percent rate is not so out of line with the generally prevailing 6 percent rate that it would likely be the sole factor provoking a plant relocation. But where other unfavorable factors, such as high labor costs, are already present,[73] a higher corporate tax rate could be the factor that sig-

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ARIZ. REV. STAT. ANN. § 43-102 (Supp. 1971-72); Arkansas, ARK STAT. ANN. § 84-2004 (Supp. 1969); Hawaii, HAWAII REV. STAT. § 235-71 (Supp. 1971); Iowa, IOWA CODE ANN. § 422.33 (1971) *as amended by* Act of June 30, 1971, § 36, [1971] Iowa Laws 451 (West's Iowa Leg. Service Supp. 1971); Kansas, KAN. STAT. ANN. § 79-32, 110 (Supp. 1971); Kentucky, KY. REV. STAT. ANN. § 141.040 (1969); Mississippi, MISS. CODE ANN. § 9220-03 (Supp. 1971); North Dakota, N.D. CENT. CODE § 57-38-30 (Supp. 1971); Wisconsin, WIS. STAT. ANN. § 71.09 (1969); in addition to Ohio, OHIO REV. CODE ANN. § 5733.06 (Baldwin Supp. 1972).

70 Indiana (2 percent), IND. ANN. STAT. § 64-3218 (Supp. 1971); Mississippi (3 percent to 4 percent), MISS. CODE ANN. § 9220-03 (Supp. 1971); Nebraska (3 percent), NEB. REV. STAT. §§ 77-2734, -2715 (Supp. 1969). Rates comparable to Ohio's prevail in Alaska, Illinois, Louisiana, Maine, and Oklahoma. *See generally* CCH STATE TAX GUIDE, ¶ 10-000 (1972).

71 Alaska (18 percent of federal income tax), ALASKA STAT. § 43.20.010(b) (1971); Iowa (6 percent to 10 percent), IOWA CODE ANN. § 422.33 (1971) *as amended by* Act of June 30, 1971, § 36, [1971] Iowa Laws 451 (West's Iowa Leg. Service Supp. 1971); Massachusetts (8.55 percent), MASS. GEN. LAWS ANN. ch. 63, § 32 (1969) (7.5 percent on net income) and MASS. GEN. LAWS ANN. ch. 63A, prec. note 1 (Supp. 1972) (14 percent surcharge); Minnesota (12 percent), MINN. STAT. ANN. § 290.06 (Supp. 1972) *as amended by* Act of October 30, 1971, ch. 31, art. VI, § 1, [1971] Minn. Laws 2014 (Minn. Sess. Leg. Service 1971); New York (9 percent) N.Y. TAX LAW § 210 (McKinney Supp. 1971-72); Pennsylvania (12 percent), Tax Reform Code of 1971, § 402, [1971] Pa. Laws 65 (Purdon Leg. Service 1971).

72 Indiana (2 percent), IND. REV. STAT. § 64-3218 (Supp. 1971); Illinois (4 percent), ILL. REV. STAT. ch. 120, § 2-201(b)(2) (Supp. 1972); Michigan (7.8 percent), Act of July 30, 1971, § 1, [1971] Mich. Laws 129 (West's Leg. Service Supp. 1972) *amending* MICH. COMP. LAWS § 206-61 (Supp. 1971); Tennessee (6 percent) TENN. CODE ANN. § 67-2701 (Supp. 1971); West Virginia (6 percent), W. VA. CODE ANN. § 11-24-4(1) (Supp. 1971). Only Pennsylvania and New York exceed Ohio in this region. *Cf.* CCH STATE TAX GUIDE ¶ 10-000 (1972).

73 It may be that Ohio's many heavy industries with considerable plant investment

nificantly influences an ultimate decision to relocate. Thus, a high tax imposed on a taxpayer with numerous options could easily result in less tax revenue than a more moderate tax.[74] Whether the legislature's decision to couple a modest personal tax with a stiff corporate tax[75] will prove sufficiently out of step with normal state tax practices to cause Ohio financial and economic detriment will only be determined after the state has had several years to analyze the effect of the tax on state revenues.

III. CONCLUSION

With acceptance of the principle of a graduated state income tax, Ohio is better prepared to meet the financial demands facing it in the decade to come. The change did not come easily, and the spectre of ever-increasing taxation makes any new revenue-raising measure, however equitable in structure, a mixed blessing. The initial taxes on personal income, however, are quite low in comparison to other states, particularly its major industrial rivals; and Cleveland, Ohio ranks near the bottom of populous cities in total income tax burden.

Analysis of the burden of the tax after the federal tax deduction shows that high-bracket taxpayers pay a smaller net percentage of their income than many taxpayers earning less than $40,000. While Ohio already has more graduation in its tax than most states, additional brackets would tend to equalize the after-tax burden at proportionately little cost to taxpayers.

The corporate tax measured by income was long in coming to Ohio, but now that the legislature has acted it may well have overshot the mark. While the two-step tax leaves the small Ohio corporation better off than its counterparts in most states, Ohio's 8 percent tax on income above $25,000 is comparatively high and could cause economic disadvantage to the state. Certainly this tax should not be raised until all other revenue possibilities are explored.

While the legislature showed questionable judgment in retaining the intangibles tax, the basic income tax structure seems to permit efficient revenue collection, at least once the initial period of

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may be less able to relocate elsewhere than smaller industries. The new tax rate will, however, be a factor in the location of new industry.

74 One example would be the substantial increase in Ohio estate tax rates contained in the original bill but not adopted in the ultimate legislation. Such rates, which would have produced Ohio taxes substantially in excess of the federal credit in most cases, could have provoked changes of domicile by wealthy taxpayers, especially retired ones, and a consequent reduction in state tax revenue.

75 The imbalance may have been dictated by organized labor's insistence that business tax increases constitute a substantial share of the increased revenue.

chaos subsides. Although an increased sales tax would probably have been more efficient because new tax collection and administrative procedures would not have been necessary, the legislature wisely avoided this regressive alternative.

Ohio's entry into the field is hardly a pioneer venture, and the state income tax experience of other states, particularly with the three-factor apportionment formula, may well prove useful in resolving difficulties. The modernization of a state's tax structure does not come easily, but Ohio's 1971 changes seem well worth the effort.

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